A New Way Forward for New Economy Listings in Hong Kong

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The Stock Exchange of Hong Kong Limited (the **Exchange**) has announced significant reforms to attract high-growth innovative companies to list in Hong Kong.

The most eye-catching reform is the concession on the Exchange's long-held "one-share-one-vote" principle – with the ability to list with non-standard governance features (such as weighted voting rights) (**WVR**) being made available to new economy companies with high market capitalisation, as well as established US and certain UK listed new economy companies via a secondary listing route.

Qualifying biotech issuers may also receive concessions on needing a revenue track record.

The Exchange's initial proposal for a segmented new board to allow new economy companies that are pre-revenue and/or possess WVR structures to list will not be pursued. Instead, new chapters will be added to the Listing Rules to accommodate the listing on the Main Board of new economy companies with WVR structures and pre-revenue biotech companies. A range of investor safeguards will be required on primary listings of WVR companies.

The draft new rules are expected to be issued for consultation in the first quarter of 2018.

The reforms represent a significant step for Hong Kong to compete more effectively with the US exchanges, as well as leveraging from them for secondary listings of PRC new economy giants.

WVR companies - primary listing

To be eligible to list with a WVR structure, applicants must be a new economy company and have a minimum expected market capitalisation of HK$10 billion.

They must in addition have at least HK$1 billion of revenue in the last financial year if their market capitalisation is less than HK$40 billion.

The thresholds have been set on the high side so that WVR companies will generally be high profile companies subject to a higher degree of public scrutiny. WVR shareholders must hold a minimum equity threshold at IPO, though the threshold has not yet been specified.

There will be no fixed definition of "new economy" or "innovative", but further guidance will be issued on expected characteristics under a guidance letter that may allow more flexibility for developing the interpretation. The applicant is currently expected to possess more than one of the following features:

- the company's success being attributable to the application of new technologies, innovations and/or business models;
- R&D being a major contributor of expected value;
- its success is demonstrated to be attributable to unique features or intellectual property; and/or
- an outsized market cap/intangible asset value relative to tangible asset value.

It remains to be seen whether companies from old economy sectors using, for example, innovative distribution methods could qualify and whether the Exchange will police the degree to which a new economy company can acquire or establish old economy businesses post-listing.

Unlike the US, the Hong Kong regime will impose on primary-listed WVR applicants: (a) an enhanced suitability assessment (summarised in Part A of Appendix 1 to this briefing); and (b) mandatory investor safeguards (summarised in Part B of Appendix 1).

In brief, the WVR suitability assessment will include factors such as:

- a trajectory of high business growth;
- contribution by WVR holders to the growth of the business; and
- third party funding from sophisticated investors, who would be subject to a 6 month lock-up of 50% of their investment.

Ordinary shares that carry zero voting rights (as seen on the US listing of Snap Inc.) are not considered suitable.

Mandatory WVR safeguards will include:

- lapse of WVRs attached to a WVR beneficiary's shares if he / she ceases to be a director (the Exchange should clarify if this means an executive director) or transfers the shares (however there will be no mandatory time-defined sunset clause);
- holding by WVR beneficiaries of a minimum equity threshold at IPO;
- the requirement for certain key decisions (including appointment and removal of INEDs) to be approved on a "one-share-one-vote" basis;
- voting power of WVR shares cannot be more than 10 times the voting power of ordinary shares and non-WVR holders must hold at least 10% of votes; and
- a corporate governance committee (comprising INEDs) to ensure the company is being managed for the benefit of all shareholders – further guidance on how this assessment should be made by the committee would be helpful.

These requirements are notably absent in the US market and so, together with the minimum market capitalisation and revenue requirements, may deter some from listing in Hong Kong, while some will consider them acceptable in light of the wider benefits of a Hong Kong listing (such as access to PRC investors through the Stock Connect system).

Only new applicants can list with a WVR structure and anti-avoidance measures will be put in place. This is probably to address concerns that already-listed companies should not be allowed to take rights away from investors that have invested on the basis of a "one-share-one-vote" principle. The Exchange notes that any spun-off entities must independently meet the WVR eligibility and suitability requirements.

Secondary listings

Another key reform is a concessionary route to secondary listings which partially lifts the blanket ban on the secondary listings of companies with a Greater China "centre of gravity" (**Greater China Companies**). Concessions will be made for new economy companies (including those with Greater China businesses) with a primary listing on the New York Stock Exchange, NASDAQ or the premium segment of the London Stock Exchange (together a **Qualifying Exchange**), a "good record of compliance" of at least 2 years and an expected market capitalisation of at least HK$10 billion.

There will again be a HK$1 billion revenue requirement for WVR companies or Greater China

Companies if their market capitalisation is less than HK$40 billion.

WVR companies applying for a secondary listing will be required to meet the same suitability requirements as on a primary listing of a WVR company and to comply with certain key shareholder protections.

Companies that meet the above criteria will be able to secondary list on the Main Board:

- with the benefit of certain automatic waivers (reflecting those normally granted on secondary listings); and
- in the case of WVR companies, without having to comply with the WVR safeguards (except for disclosure-related safeguards) unless they are a Greater China Company that primary listed after 15 December 2017. Greater China Companies that primary listed prior to this date would be grandfathered and would not be required to amend their WVR structures.

This reform is a significant step that could open the doors to the secondary listings of (in particular) Greater China new economy giants already listed in the US. Due to likely investor demand, the Exchange has anticipated the bulk of trading in the shares of a Greater China Company could migrate from its primary exchange to Hong Kong. The Exchange proposes that if 55% of the total trading volumes in the shares of a secondary listed Greater China Company takes place on the Exchange in the most recent fiscal year, it would be treated as dual primary-listed.

The effect would be that the automatic waivers would fall away after a one year grace period (other than common waivers normally granted for dual primary listings), the Hong Kong Takeovers Code would likely apply, and importantly, grandfathered Greater China Companies would be expected to comply with the WVR safeguards within the grace period - but only to the extent they are not inconsistent with their existing governance structures and do not require a change to their constitutional documents. This provides some level of comfort for grandfathered Greater China Companies, but greater clarity will be required on how this requirement will work in practice.

Pre-revenue companies

The Exchange currently permits the listing of pre-revenue mineral companies that do not meet the usual financial eligibility requirements. Under the reforms, pre-revenue biotech companies will also be permitted to list on the Main Board provided they have a minimum expected market capitalisation of HK$1.5 billion and investment from at least one sophisticated investor.

Biotech companies have been singled out for special treatment by the Exchange as they tend to be strictly regulated under a regime that sets external milestones on development progress. This concession is to be applauded, but the Exchange should be encouraged to conduct an early review of a broader spectrum of scientific research-based companies that could be permitted to list on a pre-revenue basis. It is interesting to note the Exchange proposes to discount cornerstone investors from the public float on biotech listings. Query whether this may pave the way for a wider application across all listings to facilitate post-listing liquidity and correct distortions in the price discovery process.

Revised Main Board and GEM Listing Requirements

Companies hoping to list in Hong Kong that fall outside the new regime should be aware that, following a separate consultation, the Exchange will be raising the eligibility requirements for Main Board and GEM listings on 15 February 2018. There will be a suite of changes, including: (a) increasing the minimum expected market capitalisation for a GEM listing from HK$100 million to HK$150 million and for a Main Board listing from HK$200 million to HK$500 million (with the minimum public float requirement correspondingly increasing to HK$45 million for

GEM and HK$125 million for the Main Board); (b) increasing the minimum cash flow requirement for a GEM listing from HK$20 million to HK$30 million; and (c) increasing the post-IPO controlling shareholder lock-up for GEM listings from one year to two years. There will be no increase in lock-up period for the Main Board.

Existing GEM issuers should be aware the streamlined process for GEM transfers to the Main Board will be removed from 15 February 2018. A special transitional arrangement will apply during a three-year grace period for eligible GEM issuers wishing to transfer to the Main Board.

As a result, there may be a rush of listing applicants and GEM transfer applicants prior to 15 February 2018.

Next steps

Further consultation on the details of the new regime for new economy listings will take place in the first quarter of 2018, with its implementation expected as early as mid-2018. The Exchange has had significant dialogue with Hong Kong's securities regulator – the Securities and Futures Commission **(SFC)** - prior to releasing the conclusions. The SFC is thus not expected to object to the high level concepts behind the new way forward, but will likely be involved in shaping the detailed rules to ensure appropriate investor protection.

In particular, the detailed rules and guidance on investor safeguards, the concept of "new economy" and suitability for WVR listing will be key.

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APPENDIX 1 - SUMMARY OF KEY ELIGIBILITY / SUITABILITY CRITERIA AND SAFEGUARDS FOR WVR COMPANIES

PART A - ELIGIBILITY AND SUITABILITY CRITERIA FOR WVR COMPANIES		
CRITERIA	**PRIMARY LISTING**	**SECONDARY LISTING**
SECTOR	New economy	New economy
EXPECTED MARKET CAPITALISATION	At least HK$10 billion	At least HK$10 billion (at time of secondary listing)
REVENUE	$1 billion if expected market capitalisation is less than HK$40 billion	$1 billion if expected market capitalisation is less than HK$40 billion
SUITABILITY ASSESSMENT	• Track record of high business growth that is expected to continue • Each holder of WVRs has materially contributed to business growth, has an executive role, and will be a director on listing • Meaningful third party funding from sophisticated investors (including financial institutions), with 50% of their investment subject to a 6 month lock-up post-listing • "Extreme" departures from governance norms may be rejected. One example is ordinary shares that carry zero voting rights	• Same suitability assessment as on a primary listing – see column to the left • Existing primary listing on a Qualifying Exchange • Good compliance record for at least 2 years on a Qualifying Exchange

PART B - MANDATORY INVESTOR SAFEGUARDS FOR WVR COMPANIES (applicable to (a) primary listings and (b) secondary listings of non-grandfathered Greater China Companies and (to the extent not inconsistent with its existing WVR structure and does not require changes to its constitutional document) a grandfathered Greater China Company if its bulk of trading migrates to Hong Kong)	
AREA	**SAFEGUARDS**
RING FENCING	• Limited to new listing applicants • No increases of the proportion of WVR shares post-listing (subject to a limited exception of pro-rata rights issues and open offers)
RESTRICTIONS ON WHO CAN BE WVR HOLDERS	• WVRs attached to a beneficiary's shares will lapse if he or she ceases to be a director, dies, becomes incapacitated or if the shares are transferred to another person • WVR holders must hold a minimum equity threshold at IPO - there are currently no details on the threshold
LIMITS ON WVR POWER	• WVR structure to be attached to a specific class / classes of shares • WVR shares and ordinary shares to be the same other than voting rights • The voting power attached to WVR shares cannot be more than 10 times the voting power of ordinary shares • Non-WVR holders must hold at least 10% of votes eligible to be cast at general meeting • Ability for general meeting to be convened by non-WVR holders holding at least 10% of votes on a one-share-one-vote basis • Certain key decisions must be decided on a one-share one-vote basis: (a) material changes to constitutional documents (b) variation of rights attached to class of shares (c) appointment and removal of independent non-executive directors (d) appointment and removal of auditors (e) winding-up
ENHANCED DISCLOSURE	• Unique stock code / marker and appropriate warnings in corporate communications • Appropriate warnings and full disclosure of WVR structure, rationale and associated risks in listing document • Additional disclosure requirements for US-listed "foreign private issuers" with secondary listing in Hong Kong
ENHANCED CORPORATE GOVERNANCE	• A permanent compliance adviser • A corporate governance committee comprising INEDs to ensure the company is being managed for the benefit of all shareholders. It would be helpful to receive further guidance on how this assessment should be made in practice
ENFORCEMENT	The WVR safeguards will be built into the Listing Rules, but must also be incorporated into constitutional documents so that private legal actions can be taken by shareholders for any breaches
KEY SHAREHOLDER PROTECTION STANDARDS	• Not strictly a WVR safeguard as applicable irrespective of WVRs. Key shareholder protection standards include holding an AGM at least every 15 months and requiring a super-majority shareholder approval for certain key matters (we do not view this as cutting across WVRs) • Under the concessionary secondary listing route, grandfathered Greater China Companies and non-Greater China Companies do not need to change their constitutional documents to incorporate the key standards (instead the standards will apply via the Listing Rules), but non-grandfathered Greater China Companies must incorporate the key standards into their constitutional documents